STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2004-380

July 2, 2004

BANGOR HYDRO-ELECTRIC COMPANY
Request for Approval of Special Rate Contract
With Lincoln Paper and Tissue Company and of
Guaranty of Supply Contract

ORDER APPROVING
STIPULATION
(PART II)

WELCH, Chairman; DIAMOND and REISHUS, Commissioners

I. SUMMARY

By this Part II Order, we explain our reasoning in approving a Special Rate Agreement between Bangor Hydro-Electric Company (BHE) and Lincoln Paper and Tissue, LLC (Lincoln) and a Stipulation entered into between BHE, Lincoln, and the Office of the Public Advocate (OPA).

II. BACKGROUND

Lincoln is a new customer of BHE, having purchased the paper-making facility in Lincoln, Maine on May 28, 2004 from the United States Trustee of Lincoln Pulp and Paper Company's (LPP) Chapter 7 Bankruptcy Estate. LPP had received numerous Special Rate Contracts from BHE, the latest being the 2001 Special Rate Agreement and the First Amendment to the 2001 Special Rate Agreement executed and approved in 2002.[1]

The 2001 Special Rate Agreement (SRA) and the First Amendment to the 2001 SRA resolved issues that arose because of BHE and LPP's pre-Restructuring Special Rate Contract, by which BHE supplied electricity service not just T&D service. The Restructuring Act (35-A M.R.S.A. § 3204(10)) imposed on BHE the obligation to renegotiate this pre-Restructuring rate contract by setting the T&D price at the old contract price minus LPP's new cost for generation service, provided LPP's generation service was purchased at a reasonable price. As LPP was then subject to a voluntary petition for Chapter 11 Reorganization under the United States Bankruptcy Code, BHE was concerned that a reasonable generation price for LPP was significantly higher because of LPP's adverse credit situation. Accordingly, as part of the 2001 SRA, BHE

[1] The 2001 Special Rate Agreement was approved by the Commission in Docket No. 2001-434, by a *Part I Order* on June 27, 2001 and a *Part II Order* on July 17, 2001. The Amendment to the 2001 Special Rate Agreement was approved in the same docket by an *Order* on April 30, 2002.

offered to provide LPP's generation supplier a credit guaranty and a take-or-pay provision in order to reduce LPP's cost for generation service.[2]

By helping LPP receive a lower generation price, BHE received greater contribution to T&D service from LPP. In addition, by offering LPP a credit guaranty and a take-or-pay provision as part of successive 12-month electricity supply contracts (through March 31, 2006), BHE enhanced LPP's economic viability by improving the chances that LPP could achieve and then execute an acceptable plan of reorganization.[3] We concluded that the combination of risks and rewards imposed on ratepayers by the 2001 SRA were reasonable and approved it in Docket No. 2001-434, *Order Approving Stipulation (Part I),* June 27, 2001, *Order Approving Stipulation (Part II),* July 17, 2001.

Sprague Energy Corporation (Sprague) became LPP's electricity supplier in 2003, pursuant to a contract signed in 2002. In conjunction with the 2002 electricity supply contract between Sprague and LPP, Sprague and BHE entered into the 2002 Guarantee Agreement, and BHE and LPP executed the First Amendment to the 2001 Special Rate Agreement. On April 30, 2002, the Commission approved the Guaranty Agreement between BHE and Sprague and the First Amendment to the 2001 SRA.[4]

LPP defaulted under the supply agreement with Sprague in January 2004. Thereafter, Sprague called upon BHE to perform under its guaranty. A dispute arose between BHE and Sprague as to each other's rights and obligations under the Guaranty Agreement. As the agreement provided that disputes would be resolved by the Commission, BHE filed a petition to resolve the dispute on April 8, 2004. The petition was assigned Docket No. 2004-239.

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[2] There were various safeguards to assure that LPP acted reasonably in selecting a supplier and to reduce the financial risk imposed on BHE and its ratepayers by offering the credit guaranty and take-or-pay provision. One important safeguard was to limit the term of supply contracts to one year.

[3] The 2001 SRA also provided for potentially larger T&D contributions by determining LPP's T&D rate by a formula meant to increase the rate as LPP became more profitable.

[4] As the LPP-Sprague power supply contract was for two years rather one, both the Guaranty Agreement and the First Amendment were beyond the approval granted by the Commission in the June 27 Part I and the July 17 Part II Orders. Accordingly, we approved the First Amendment and Guaranty Agreement in *Order*, Docket No. 2001-434 (April 30, 2002).

During May, 2004, Lincoln was looking to close on its purchase of the LPP facility,[5] and to arrange for a new power supply agreement with a competitive electricity provider (CEP) and a power delivery agreement with BHE. BHE and Sprague saw Lincoln reopening the paper-making facility as an opportunity to resolve their dispute concerning the 2002 Guaranty Agreement, including each other's rights and obligations under the LPP-Sprague power supply contract, to the advantage of both parties. The reopening of the paper-making facility could provide BHE (and its ratepayers) with more benefits than any possible stand-alone resolution of its dispute with Sprague. Sprague preferred to convert the old LPP-Sprague power contract into a new power supply agreement with Lincoln, as such a result was consistent with Sprague's view of its dispute with BHE, and avoided the least favorable resolution of that dispute, a determination that the LPP-Sprague contract was terminated and that Sprague owed BHE a substantial termination payment.

Moreover, Lincoln could also benefit because the prior LPP-Sprague power arrangement was based on 2002 market prices, considerably lower than 2004 market prices. In combination with a discounted T&D rate, lower generation costs could assure the viability of Lincoln's business plan despite recent energy price increases. Accordingly, the three parties, Lincoln, BHE and Sprague began discussions to negotiate a new electricity supply contract between Sprague and Lincoln, a new discounted T&D contract between BHE and Lincoln and a resolution of the BHE-Sprague dispute over the 2002 Guaranty Agreement. The Commission's Staff and the Office of the Public Advocate participated in these negotiations, because these matters significantly impact future T&D rates.

After weeks of negotiations, on June 11, 2004, BHE and Lincoln entered into a Special Rate Agreement for discounted T&D service to Lincoln's paper-making facility, for a term from May 28, 2004 though May 31, 2006 (the 2004 SRA). Lincoln and BHE agree that, for the first 10 months of the 2004 SRA, Lincoln shall pay a T&D rate of 1.1¢/kWh. For the remaining 14 months of the agreement, Lincoln will pay for T&D service at 1.5¢/kWh. LPP was paying BHE approximately 0.9¢/kWh at the time of LPP's default, so Lincoln is expected to provide greater contribution than LPP during both time periods.

During the first 10 months (through March 31, 2005), Lincoln will obtain electricity supply for Sprague pursuant to a new power supply contract. As part of the 2004 SRA, BHE agrees to provide a credit guaranty in the form of a new Guaranty Agreement (the 2004 Guaranty Agreement), which is attached to the 2004 SRA. The terms of the 2004 Guaranty Agreement are similar to the 2002 Guaranty Agreement, except that BHE's options in regards to a Lincoln default under the new supply contract are defined in a way to eliminate the cause of the dispute over the 2002 Guaranty Agreement. Under the 2004 Guaranty Agreement, BHE may cure Lincoln's default and maintain the Lincoln-Sprague supply contract, or simply terminate the supply contract, whereupon

[5] On February 4, 2004, a short time after LLP shut down the paper-making facility, LPP's Chapter 11 Bankruptcy case was converted to a Chapter 7 Liquidation.

Sprague will sell the power into the day-ahead market, and collect from or pay to BHE the difference between the $42.95/mWh price and the amount received in the day-ahead market, minus a set fee to account for Sprague's to administer the day-ahead sales.

The Lincoln-Sprague supply contract is confidential as proprietary business information. We can note that the terms of the Lincoln-Sprague contract are similar to the LPP-Sprague arrangement. Most importantly, Lincoln will pay for power at prices similar to those in the LPP-Sprague contract, which because they reflect 2002 market prices, are considerably lower than current market prices. The Lincoln price is adjusted to reflect the increased cost of reverting the underlying LPP-Sprague contract from a wholesale contract that had been assigned to BHE back to a load following retail contract with Lincoln.[6]

The 2004 Guaranty Agreement calls for disputes to be settled by arbitration. The arbitrator is to be chosen by BHE and Sprague, and by the Commission if BHE and Sprague are unable to agree on one. BHE and Sprague agree that the OPA can participate in the arbitration proceeding as an interested party.

The terms of 2004 SRA also call for Lincoln to provide BHE a customer deposit of $175,000, weekly meter reads and invoices, and payments by Lincoln within the same week as the invoice is received, and other provisions intended to limit the amount of past-due balances Lincoln can accumulate before BHE can terminate the rate agreement. In addition, Lincoln agrees not to employ any self-generation at the paper-making facility beyond that already installed, unless the self generation is to serve increase load at the mill.

The 2004 SRA is contingent on Commission approval, the issuance by the Commission of an accounting order that permits BHE to defer all the costs and revenue associated with the rate agreement and credit guaranty, Commission approval of the credit Guaranty Agreement, and the Commission's waiver of any Chapter 301 provisions necessary for Lincoln to purchase generation services from Sprague.

On June 11, 2004, BHE filed an Unopposed Motion to Dismiss With Prejudice in the BHE-Sprague dispute proceeding, Docket No. 2004-239. Attached to BHE's Motion is a Settlement and Mutual Release Agreement, which resolves all claims alleged in BHE's Petition concerning its dispute arising under the 2002 Guaranty Agreement.

By the Settlement and Mutual Release Agreement, BHE agrees to pay Sprague for the power LPP had not paid Sprague for under the 2002 Power Supply Contract,

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[6] The essence of the BHE-Sprague dispute concerned whether the LPP-Sprague contract had been assumed by BHE and thereby converted to a wholesale strip of power, or had been terminated by BHE in a manner that required a termination payment from Sprague to BHE. In either event, the retail, load-following contract to serve the LPP paper-making facility no longer existed.

plus interest ($385,638). Sprague agrees to pay BHE $102,190, which is the amount of proceeds Sprague received for selling the power from the 2002 LPP-Sprague Power Supply Contract into the day-ahead market since the day BHE instructed Sprague to stop delivering the power to LPP, net of Sprague's selling costs.

Also on June 11, 2004, BHE, Lincoln and the OPA filed a Stipulation with the Commission in this Docket. The stipulating parties recommend that the Commission approve the 2004 SRA. In addition, the parties recommend that the Commission determine that BHE acted prudently in regards to its rights and obligations under the 2002 Guaranty Agreement, by agreeing to dismiss with prejudice its petition against Sprague in Docket No. 2004-239 and entering into a Settlement and Mutual Release Agreement with Sprague by which BHE and Sprague agree to settle all disputes and claims arising under the 2002 Guaranty Agreement.

The Settlement and Mutual Release Agreement is conditioned in the Commission's granting BHE's motion to dismiss with prejudice its petition in Docket No. 2004-239 and approving the Stipulation filed in this proceeding. The Stipulation also requires that Sprague enter into the 2004 Retail Electricity Sale Conformation Agreement with Lincoln, the terms of which were described above.

On June 11, 2004, we issued an *Order* in Docket No. 2004-239 that granted BHE's motion to dismiss its petition with prejudice. On the same day, we issued a Part I Order in this docket, in which we approved the Stipulation, the 2004 SRA and 2004 Guaranty Agreement. The Part I Order also granted the necessary accounting orders, as well as the Chapter 301 waivers. In this Part II Order, we explain our reasoning in reaching these decisions.

III. DECISION

In past cases, we have applied the following criteria when considering stipulations:

1. whether the parties joining the stipulation represent a sufficiently broad spectrum of interests that the Commission can be sure that there is no appearance or reality of disenfranchisement;

2. whether the process that led to the stipulation was fair to all parties; and,

3. whether the stipulated result is reasonable and is not contrary to legislative mandate.

See Central Maine Power Company, Proposed Increase in Rates, Docket No. 92-345(II), Detailed Opinion and Subsidiary Findings (Me. P.U.C. Jan. 10, 1995), and *Maine Public Service Company, Proposed Increase in Rates (Rate Design),* Docket No. 95-052, Order (Me. P.U.C. June 26, 1996). We have also recognized that we have an obligation to ensure that the overall stipulated result is in the public interest. *See*

Northern Utilities, Inc., Proposed Environmental Response Cost Recovery, Docket No. 96-678, Order Approving Stipulation (Me. P.U.C. April 28, 1997). We find that the Stipulation in this case meets all of the above criteria.

BHE, Lincoln and the OPA have joined the Stipulation. Generally, we find that special contract proceedings do not involve issues of substantial public interest sufficient to warrant public notice and opportunity to intervene as provided in Chapter 110, § 712.[7] Moreover, the nature of the business arrangements between the customer and utility (and generation supplier) often require expedited review. The utility, the customer and the public agency that serves the interests of ratepayers represent the entire spectrum of interest in this matter.

All parties have joined the Stipulation. Therefore they must accept that the process that led to the Stipulation was fair. We note that members of the Commission Staff and the OPA participated in many of the discussions and meetings that led to the Stipulation, and the various other agreements upon which the Stipulation is based.

Finally, we find that the Stipulation, in conjunction with the settlement of the dispute surrounding the 2002 Guaranty Agreement, represents a fair and reasonable resolution to the many issues facing BHE, Lincoln, Sprague and ratepayers.

LPP was BHE's second largest customer. The loss of such a customer would have a significant impact on the level of BHE's core rates. The 2004 SRA, in conjunction with the 2004 power supply contract between Sprague and Lincoln and the 2004 Guaranty Agreement, promote the viability of Lincoln's paper-making facility. For the past few months, it appeared as if the contribution from that facility would be zero. Now the contribution will be significant. In fact, it will be greater than that provided by LPP under its special rate contract. Thus, the Lincoln T&D discount seems reasonable even without considering the recent history of LPP.

In addition to the rate discount, BHE promotes Lincoln's new efforts of operating the paper-making facility by resolving the BHE-Sprague dispute such that Lincoln receives the value of the LPP-Sprague power supply arrangement going forward, which includes BHE offering a credit guaranty and take-or-pay provision. BHE also agrees to provide a credit guaranty and take-or-pay provision to Lincoln's generation supplier after Sprague, for up to 14 months after the 2004 Sprague contract expires. In regards to the credit guaranty and take-or-pay provision, the 2004 SRA is essentially identical to the 2001 SRA with LPP.

[7] In this sentence, we refer to special contract approval requests that are brought pursuant to section 703 and not part of a pricing flexibility plan approved as part of an alternative rate plan. In such a pricing flexibility plan, minimal notice and review is generally required. The 2004 SRA is not brought to the Commission as part of BHE's pricing flexibility plan.

As we noted in the LPP contract cases, electricity is a significant cost to the paper-making facility in Lincoln. Assurance of a reasonably-priced source of electricity, particularly for the first 2 years of its operation, is important to the viability of the paper-making facility in Lincoln. Therefore, we believe that BHE's decision to pass onto Lincoln the same benefit that BHE had granted LPP, namely assistance is assuring reasonably-priced electricity by offering a credit guaranty and take-or-pay provision until 2006, significantly improves the ability of Lincoln to successfully execute the first two years of its business plan and therefore maximizes Lincoln's contribution to BHE's fixed costs.

We continue to find that the benefits to ratepayers outweigh the risks imposed on them by the Guaranty Agreement. The credit risks are limited by the weekly electronic billing and obligation to pay by electronic funds transfer (EFT) within the same week after billing. These payment obligations mean that Lincoln should not be able to accumulate arrearages as large as those accumulated by LPP. In addition, Lincoln must provide a significant deposit to BHE. We also find that the changes to the 2002 Guaranty Agreement that are made in the 2004 Guaranty Agreement, such as the arbitration provision and BHE's options if Lincoln defaults, do not materially increase the benefits and risks of the 2004 Guaranty Agreement compared to the 2002 Guaranty Agreement. Those changes are merely intended to make the guaranty easier to administer.

Although the prices in the Sprague-Lincoln contract are confidential, we can note that these prices are based on the price from the Sprague-LPP contract, adjusted for changes to the power supply arrangement caused when it ceased to be a load-following arrangement. As the Sprague-LPP prices were consistent with the electricity market in 2002, those prices compare favorably to today's market prices. Therefore, we see little risk in the liquidation obligation if BHE terminates the Sprague contract.

Ratepayers assume some risks after the 10-month Sprague contract expires if Lincoln opts to require BHE to provide a take-or-pay obligation to the electricity supplier. However, these are the same risks that ratepayers faced since 2001 when we approved the 2001 SRA. We found the risks to be "greatly mitigated" by the fact that any power supply contract cannot be for more than 12 months. We do not view a 14-month contract as significantly riskier than a 12-month one.

The dismissal by BHE of its petition against Sprague, as well as the Settlement and Mutual Release Agreement between BHE and Sprague, are integral parts of the 2004 SRA between BHE and Lincoln. We conclude that BHE is reasonable and prudent for settling its dispute with Sprague in this manner. Regardless of whether BHE or Sprague prevailed, the LPP-Sprague contract no longer existed as a retail load-following contract. Either BHE assumed the contract and converted it to a wholesale contract or the contract was terminated and BHE was entitled to a termination payment. BHE's decision to allow Sprague to convert its underlying wholesale arrangement back into a retail full requirements contract for the benefit of Lincoln is a fair resolution of the BHE dispute, when combined with Sprague's payment to BHE of the value it received

for the power supply contract while the dispute was pending and with BHE's payment to Sprague for the power consumed but not paid for by LPP. By maintaining the value of the 2002 LPP-Sprague market-based supply contract and allowing Lincoln to receive that value going forward, BHE increases Lincoln's viability and the opportunity that BHE (and ratepayers) will receive considerably more value in the way of Lincoln's contribution than BHE would receive even if it was successful in its dispute with Sprague.

In support of our finding that benefits outweigh risks, we note that even after LPP's shutdown and default, and BHE's payments to Sprague under the credit guaranty, LPP's increased contributions were larger than BHE's payments. Therefore, by the operation of the accounting orders in Docket No. 2001-434, a regulatory liability rather than a regulatory asset was created of more than $350,000.

We also find that the proposed accounting orders called for in the Stipulation are reasonable. It is fair for ratepayers to receive both the benefits and bear the burdens of Lincoln's special rate arrangement.

The Stipulation also called for the Commission to waive the opt-out fee under Chapter 301(2)(c)(2) and the notice requirement under chapter 301 (D)(3) of our Rules, in regards to Lincoln's purchase of electricity from Sprague. In our Part I Order, we ruled that an opt-out fee would not apply because Lincoln was a new customer and had never received generation service from a competitive electricity provider. We granted a waiver from the notice requirement of Chapter 301, § (D)(3), because BHE joined in the request for a waiver and the 48-hours notice provision is for the T&D utility's benefit.

In the Part I Order, we approved the 2004 Guaranty Agreement Pursuant to 35-A M.R.S.A. § 902. We did so because the Stipulation calls for the Commission to issue an order authorizing BHE to enter into the 2004 Guaranty agreement. Although it is not clear that section 902 authorization is required for the 2004 Guaranty Agreement with Sprague, as its term will be less than 12 months, we did so as the Stipulation asked for such approval. If BHE enters into a 14-month Guaranty Agreement with Lincoln's next generation supplier, section 902 authorization is required, and BHE is authorized to do so as long as the Guaranty Agreement is in the same form as the 2004 Agreement. BHE of course must determine that the conditions imposed on Lincoln in the 2004 SRA have been satisfied before BHE is to enter into a new Guaranty Agreement.

The necessary ordering paragraphs were stated in Order Part I (and in the Order in Docket No. 2004-239) and do not need to be repeated. The Administrative Director also shall file a copy of this Part II Order in Docket No. 2004-239 as this Part II Order also explains our reasoning in approving BHE's voluntary dismissal of its petition in Docket No. 2004-239.

Dated at Augusta, Maine, this 2nd day of July, 2004.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Diamond
Reishus

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

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